

Message Text

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ACTION EUR-12

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SUBJECT: ECONOMIC PROJECTIONS FOR 1978

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PARIS FOR USOECD; BRUSSELS FOR USEEC

1. AS 1977 DRAWS TO A CLOSE, WE HAVE MADE PRELIMINARY PROJECTIONS OF THE MOST IMPORTANT ECONOMIC AGGREGATES IN 1978. SEVERAL IMPORTANT PARAMETERS ARE STILL UNDETERMINED (E.G. THE BUDGET DEFICIT, WAGE AND SALARY INCREASES, ETC.), SO ALL ESTIMATES ARE TENTATIVE. ON THE ASSUMPTION THAT THE BUDGET WILL BE SLIGHTLY MORE EXPANSIONARY THIS YEAR, WAGE AND SALARY INCREASES WILL AGAIN BE AROUND 15 PERCENT, OIL PRICES WILL REMAIN AT THEIR CURRENT LEVEL, AND THE EXCHANGE RATE WILL REMAIN RELATIVELY STABLE, THE PRELIMINARY OUTLOOK FOR THE GREEK ECONOMY IN 1978 IS AS FOLLOWS:

2. GROWTH AND INFLATION: THE ECONOMY SHOULD ATTAIN A SOMEWHAT LIMITED OFFICIAL USE

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HIGHER RATE OF GROWTH NEXT YEAR, WITH A REAL INCREASE IN GNP AT MARKET PRICES OF AROUND 5-6 PER CENT. THIS ASSUMES AN INCREASE IN AGRICULTURAL PRODUCTION OF APPROXIMATELY 3 PERCENT (ACTUALLY A RETURN TO THE 1975 LEVEL AFTER TWO YEARS OF DECLINE), A GROWTH IN SERVICES OF 5-6 PERCENT, OVER 10 PERCENT INCREASE IN CONSTRUCTION ACTIVITY, AND A GROWTH IN INDUSTRIAL PRODUCTION OF 6 PERCENT OR MORE. THE LAST WILL BE THE CRITICAL DETERMINANT, AND WILL

DEPEND UPON THE GOVERNMENT'S ABILITY TO STIMULATE INVESTMENT. IF THIS GROWTH RATE IS ACHIEVED, AND IF THE GOG INSTITUTES THE EXPANSIONARY FISCAL POLICY ANNOUNCED IN CARAMANLIS' RECENT SPEECH TO PARLIAMENT (REF B), IT WILL BE DIFFICULT (IF NOT IMPOSSIBLE) TO BRING THE INFLATION RATE BELOW THIS YEAR'S AVERAGE OF AROUND 12 PERCENT. THE BANK OF GREECE HOPES TO REDUCE THE RATE OF INCREASE OF THE MONEY SUPPLY, WHICH THIS YEAR SHOULD REACH AROUND 20 PERCENT, AND HOLD WAGE INCREASES TO 10 PERCENT, IN ORDER TO BRING DOWN THE RATE OF INFLATION; BUT THE GOG TARGET FOR GROWTH AND EXPANSION CONFLICTS WITH THIS GOAL, AND CARAMANLIS SEEMS TO BE ACCORDING PRIORITY TO THE FORMER. THE GOG'S REAL PRIORITIES, HOWEVER, WILL BECOME CLEARER WHEN THE BUDGET IS SUBMITTED TO PARLIAMENT.

3. BALANCE OF PAYMENTS: CETERIS PARIBUS, THE BALANCE OF PAYMENTS WILL CONTINUE TO IMPROVE DURING 1978. BANK OF GREECE PRELIMINARY ESTIMATES, GIVEN TO US ON A PRIVILEGED BASIS, FORESEE A 15 PERCENT GROWTH IN EXPORTS TO AROUND \$3 BILLION, A 12 PERCENT INCREASE IN IMPORTS TO APPROXIMATELY \$7 BILLION, AND CONSEQUENTLY ABOUT A TEN PERCENT GROWTH IN THE TRADE DEFICIT TO \$4 BILLION. THIS WILL BE COVERED IN LARGE PART BY INVISIBLES--TOURISM TO REACH \$1.15 BILLION, EMIGRANT AND WORKERS' REMITTANCES ABOUT \$1 BILLION, AND SHIPPING REMITTANCES \$1.3 BILLION OR MORE-- LEAVING THE CURRENT ACCOUNT DEFICIT AT APPROXIMATELY THE SAME LEVEL IT HAS BEEN SINCE 1975, I.E. \$1.1 BILLION. THUS GREECE'S EXTERNAL PAYMENTS POSITION CONTINUES TO STRENGTHEN, SINCE LIMITED OFFICIAL USE

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THE CURRENT ACCOUNT DEFICIT IS AN EVER-DECREASING AMOUNT BOTH IN REAL TERMS AND AS A PERCENTAGE OF GNP. THE CAPITAL ACCOUNT LOOKS SIMILARLY PROPITIOUS. INFLOWS IN FOREIGN EXCHANGE DEPOSITS AND NON-ENTREPRENEURIAL CAPITAL MOSTLY FOR HOUSING, AT AN ESTIMATED \$1.3 BILLION, SHOULD AGAIN BE ITS MAINSTAY. WE DO NOT FORESEE ANY SIGNIFICANT REVERSAL IN THE STAGNATION OF NET FOREIGN INVESTMENT INFLOWS NEXT YEAR. EVEN IF THE GOVERNMENT SUCCEEDS IN ITS EFFORTS TO STIMULATE PRODUCTIVE INVESTMENT AND ATTRACT FOREIGN CAPITAL, MOST OF THE EFFECT SHOULD BE FELT FURTHER IN THE FUTURE DUE TO THE INEVITABLE LAG BETWEEN PLANNING AND REALIZATION OF PROJECTS. AMORTIZATION OF EXTERNAL DEBT AT AROUND \$400 MILLION SHOULD AGAIN SLIGHTLY EXCEED NEW OFFICIAL BORROWING, RESULTING IN ANOTHER DROP IN THE TOTAL EXTERNAL DEBT AND DEBT SERVICE RATIO.

4. EXCHANGE RATE AND DOLLAR/DRACHMA PARITY: DESPITE PERSISTENT RUMORS ABOUT A POSSIBLE DEVALUATION OF THE DRACHMA, WE ESTIMATE THE AVERAGE EXCHANGE RATE FOR 1978 (BARRING UNFORESEEN STRENGTHENING OF THE DOLLAR VIS-A-VIS MAJOR EUROPEAN CURRENCIES) AT AROUND 37 DR EQUALS \$1, A SLIGHT DEPRECIATION OF THE CURRENT RATE BUT APPROXIMATELY EQUAL TO THE EQUILIBRIUM RATE EARLIER THIS YEAR, BEFORE THE DOLLAR BEGAN TO DECLINE. THE DRACHMA EXCHANGE RATE

VIS-A-VIS OTHER CURRENCIES IS COMPLETELY MANAGED BY THE BANK OF GREECE. IN JULY 1975 THE DRACHMA WAS DISENGAGED FROM THE DOLLAR, AND ITS PARITY LINKED TO AN INDICATIVE BASKET OF EUROPEAN CURRENCIES, EXCLUDING THE DOLLAR VALUE
ACUTAL PARITY IS SET BY
BANK OF GREECE OFFICIALS WITHA VIEW TO MINIMIZING THE INFLATIONARY IMPACT OF THE EXCHANGE RATE WHILE MAXIMIZING THE COMPETITIVENESS OF GREEK IMPORTS. IN RECENT MONTHS, DUE TO THE PRECIPITOUS SLIDE OF THE DOLLAR, THE DRACHMA HAS APPRECIATED VIS-A-VIS THE DOLLAR BY ABOUT 5 PERCENT, FROM A LOW OF 37.2 IN FEBRUARY TO A HIGH OF 35.4 TODAY.

5. BECAUSE OF THE POTENTIALLY INFLATIONARY IMPACT OF A GREATER DEPRECIATION AGAINST EUROPEAN CURRENCIES--44 PERCENT OF GREECE'S LIMITED OFFICIAL USE

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1976 IMPORTS WERE FROM THE EC--THE BANK OF GREECE IS RELUCTANT TO FOLLOW THE CONTINUING DOWNWARD COURSE OF THE DOLLAR. ON THE OTHER HAND, SINCE MANY EXPORT CONTRACTS ARE DENOMINATED IN DOLLARS, PROTESTS FROM EXPORTERS WHO RECEIVE FEWER DRACHMAS FROM THEIR OVERSEAS SALES ARE RISING. FOR THIS REASON, THE BANK MAY DECIDE TO READJUST THE DRACHMA/DOLLAR PARITY SOMEWHAT. IT IS UNLIKELY THIS READJUSTMENT WILL MOVE LOWER THAN THE FORMER 37-38 DRACHMA/DOLLAR PARITY BECAUSE OF GREECE'S STRONG RESERVE POSITION AND THE GOG DESIRE TO RESTRAIN INFLATIONARY PRESSURES. IF THE DOLLAR ALSO STRENGTHENS IN INTERNATIONAL MARKETS DURING 1978, THE AVERAGE PARITY FOR THE YEAR SHOULD BE AROUND THIS MORE REALISTIC LEVEL.
BANK OF GREECE OFFICIALS HAVE TOLD US CATEGORICALLY THAT NO "DEVALUATION" OF THE DRACHMA IS JUTIFIED OR CONTEMPLATED--
"DEVALUATION"
IN THIS SENSE MEANING A DROP BELOW THE LONGER-TERM EQUILIBRIUM RATE OF AROUND 37 DRACHMAS. OF COURSE, IF GREECE'S 12 PERCENT AVERAGE INFLATION RATE CONTINUES, THE LONGER-TERM TREND OF THE DRACHMA PARITY WILL HAVE TO BE DOWNWARD, BUT THE LONGER TERM IS MORE LIKELY TWO-THREE YEARS.
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